



REVIEW

A Review of the NGO Coalition for "Improving Transparency in Extractive Industries" (ITEI) on 2013 EITI report (This review has been discussed and endorsed at the Council meeting of the NGO Coalition for "Improving Transparency in Extractive Industries" held on August 24, 2015)

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Table of contents

Introduction

- I. Distinctive features of the 2013 EITI Report**
- II. Analysis of the “Contextual information” section of the report**
- III. Analysis of the main section of the report (reconciliation process and its results)**
- IV. Results and Recommendations**

INTRODUCTION

Azerbaijan develops and discloses EITI reports annually since 2004. However it is a first EITI report based on the EITI Standard adopted at Global EITI Conference held in Sydney on May 25, 2013 and in line with a schedule set by the International EITI Board.

2013 EITI report was developed by “Moore Stephens-Azerbaijan” audit firm based on the request of Multi-stakeholder Group (MSG) and covers the fiscal year which ended on December 31, 2013.

Experts of the ITEI NGO Coalition prepared this Review by thoroughly examining 2013 EITI report of the Republic of Azerbaijan, through collation and assessment of the Report’s content and structure with the requirements of the EITI Standard and necessary analysis and investigations in line with the article 2.4.9 of the Memorandum of Understanding “On Application of the Extractive Industries Transparency Initiative in the Republic of Azerbaijan” signed in 2014 between MSG Parties. Review puts an emphasis on the features of the 2013 EITI Report and states data gaps in “Contextual information” section of the report (as compared to the requirements of the EITI Standard) and discrepancies arising from the reconciliation process. In the meantime the Review provides essential recommendations to eliminate these shortcomings and gaps.

The Review has been discussed and endorsed at the Council meeting of the NGO Coalition for "Improving Transparency in Extractive Industries" held on August 24, 2015 and was presented to MSG.

I. Features of 2013 EITI Report

1.1. Due to fact that the requirements on EITI reporting based on EITI Standard that was approved in Global EITI Conference in Sydney (report’s content, structure, information content, scope etc.) differed from previous requirements, it took up to 12 months to develop and present 2013 EITI Report of the Republic of Azerbaijan.

The initial version of the report was presented by the “Moore Stephens-Azerbaijan” firm to MSG in October, 2014. The ITEI NGO Coalition at that time communicated the identified shortcomings and recommendations to MSG and to “Moore Stephens-Azerbaijan” firm. However, the draft report’s compliance with EITI Standard requirements was evaluated during Validation process that was held in January-March 2015 according to Board decision; shortcomings and recommendations were also presented.

Thus, the draft report was improved based on the numerous discussions at MSG meetings and with assistance of the Working Group established by MSG where Coalition experts were also presented. The final version of the report which we are providing a review was adopted by MSG on July 16, 2015.

1.2. Active involvement of the Working Group established the decision of the MSG with equal representation of all parties in the process of development and improvement of this report

was also a different approach versus the experience of previous years. Parties played significant role in the improvement of the draft document by contributing to the report and particularly to the development of contextual information section.

1.3. Previous years' EITI reports contained only the aggregated information regarding the payments of the companies to the government. However, 2013 EITI Report contains disaggregated data collected from all extracting companies that are EITI process participants, on all payment types and active PSAs. It will allow local citizens and interested parties to get more detailed and comprehensive information.

1.4. In line with the requirements of EITI Standard the "Contextual information" section of the 2013 EITI report contains the following information: information regarding the legal and fiscal regime regulating the operations in the extractive industry; production and export data in the extractive industry and the territorial structure of the production; exploration activities; government's share in the production; employment; various operation aspects of the national oil company SOCAR; payments by the production companies and share of the extractive revenues in government receipts and some other information and statistical indicators. Availability of mentioned information should be considered as an improvement in accessibility of comprehensive data on extractive industry and its role in country economy.

1.5. The other characteristic feature of the 2013 EITI report versus the reports of previous years is the full disaggregation of data on the company names and tax IDs and products and partial disaggregation on contracts. Inclusion of the templates presented to the Independent Auditor (Audit Firm) for the reconciliation purposes at the stage of report development to the report content is yet another advantage of 2013 EITI report. It allows to identify and disclose companies that committed errors and deviations in report data.

1.6. One of the important features of the 2013 EITI report is provided attestation procedures by Independent Auditor (Audit Firm) on randomly selected data to get further assurance regarding the operations within reconciliation process.

II. Analysis of the "Contextual information" section of the report

According to requirement 3 of the EITI Standard, the EITI Report should include contextual information regarding extractive industries. Standard also specifies the content of the contextual information that has to be reflected in the report. It is statutory requirement to have part of contextual information available in the report; some other information disclosure is only recommended. Given the fact that it is a first time when report was developed under the new EITI Standard, MSG agreed to have only required information by Standard in 2013 EITI report.

2.1 The assessment of the information developed on the basis of requirement 3 of EITI Standard shows that the majority of required by Standard information was included and presented in the report.

2.2 Assessment of the compliance and gap analysis showed that the disclosed information based on the requirement 3.2 of the Standard regarding legal norms, fiscal mode and role of the government agencies primarily describes the existing situation. It would be a good practice however to put a special focus on any changes (reforms) made to legal norms, fiscal mode and role of the government agencies specifically in the reporting year of 2013. Page 18 of the report states that “there was no significant reform conducted by government in the extractive industries for the financial year covering EITI Reporting period. However, the Ministry of Energy of the Republic of Azerbaijan was established by the decree No. 3 of the President of the Republic of Azerbaijan dated 22nd of October 2013. Based on that decree the Ministry of Industry and Energy was reorganized into the Ministry of Energy by delegating its authorities on regulation of the industry to the Ministry of Economy and Industry¹. This change can be recognized as an institutional reform and was to be noted in the Report.

Review of the decisions and ordinances of the Cabinet of Ministers pertaining to the extractive industries and fiscal mode in Azerbaijan also is missing in contextual part of the Report. Mutual substitution of tax liabilities is noted in the Section 5.6 “Amendments” of the Report as the reason of the discrepancy to the amount of 17 million AZN in the profit tax paid by SOCAR to the government. As long as the legal reason for such substitution is related to the fiscal mode, it has to be mentioned in this part of the Report (for example, Ordinance of the Cabinet of Ministers No. 443, dated December 30, 2011 is a document regarding tax liabilities substitution mechanism of the enterprises under SOCAR’s structure²).

Based on the requirement 3.2 of the Standard information on fiscal devolution should also be stated in the EITI Report. Under the existing laws of the Republic of Azerbaijan mineral tax on the construction materials of local significance (brick and ceramic clays, construction sands and gravel raw material) is paid to the local budget (municipal budget)³. We consider it is necessary to include this information into EITI Report.

In the first sentence of the section on page 16 of the Report which explains the procedures for conclusion of Product Sharing Agreements in the Republic of Azerbaijan, SOCAR is mentioned as subordinated by Ministry of the Energy of the Republic of Azerbaijan. We believe this information is wrong and it is necessary to correct an error as long as there is not any provision in the national legislation stating SOCAR as a company subordinated by any government institution.

2.3 Paragraph 3.3 of the requirement 3 of EITI Standard requires publication of summary of the extractive industries and any significant exploration activities in country. Section 3.2 of the 2013 EITI Report contains information on oil and gas industry, including total oil and gas reserves of country, current contracts on oil and gas fields, oil and gas pipelines, production of gold and silver and some data regarding exploration activities on specific fields. However inclusion of information on volumes of reserves on all types of deposits and products (oil, gas, condensate, gold, silver etc.) in next years will serve to increase transparency. (For example, this

¹<http://www.minenergy.gov.az/?e=501&a=2>

²<http://e-qanun.gov.az/framework/22855>

³Tax Code of the Republic of Azerbaijan, Chapter XVI (Mining Tax), Article 217, paragraph 217-5

information is disclosed in 2013 EITI Report of Kazakhstan). It would also be a good practice to expand information in the report on pipelines (transmission capacity and exported products' statistics).

2.4. Section 3.3 of the EITI Report under the requirement 3.4 of the Standard contains information on contribution of the extractive industries to country economy (share in annual GDP, public revenues, export, total employment, share of the extractives in fixed capital investments, regional structure of the production) for the fiscal year covering reporting period. However, there is room for further enrichment of this information in the reports of next years. Disclosure of information on investment and employment presented in this section in disaggregated way by companies could improve the quality of the report. In the meantime, disclosure of the information on the employed staff in extractive companies classified into locals and expatriates could allow to evaluate the compliance with norms established in PSAs. Therefore we believe it would make sense to improve information and complete the data in this section in reports of next years.

2.5. Section 3.4 of the EITI Report titled as "Production Volume" (page 27) contains general information on in-kind revenues made by local and foreign extractive companies to the government of Azerbaijan in 2013 under the requirement 3.5 of the EITI Standard. However Requirement 3.5 of the Standard requires disclosure of production and export indicators in the reporting period. Standard clearly requires the following information for the fiscal year of the reporting period to be disclosed in EITI Report:

- General production volumes and value of the products by types (where possible production value by regions);
- General export volumes and export value of products by types (where possible export value by regions)

Consequently, conducted assessment by us allows to say that information in the section 3.4 of the Report is not in compliance with the requirement 3.5 of the EITI Standard. Therefore, we believe it is necessary to further improve this section of the Report and bring it into conformance with the requirement 3.5 of the Standard.

2.6 Paragraph 3.6 of the requirement 3 of Standard lays emphasis on the inclusion of information on government participation in the extractive industry to the EITI report. We would like to express following in regards with compliance of Report with the requirement 3.6 of the Standard:

2.6.1. There is a need for some editing in the section 3.5a of the EITI Report. A phrase "completely" in the second sentence of the section's first paragraph should be replaced with a phrase "partially". Second paragraph should be edited from stylistics point of view and a reference to a legal source of the procedure mentioned in this paragraph should be included. SOCAR's Company Charter must be referred to as the source of for remarks in paragraph 3. There should be clarity on statement in this paragraph, i.e. "SOCAR, which shares is 100% owned by the state has obligations towards the government institutions" (what are those obligations specifically?);

2.6.2. In accordance with semi-paragraph 3.6 a) of Requirement 3 if participation of government in the extractive industry entails significant increase in revenues payments, the rules and practices on regulating financial relations amongst government and state company should be included in EITI Report. Based on the requirement of this semi-paragraph, there is general information about SOCAR, production and financial outcomes of SOCAR's for last 3 years, payments to state budget, loans and guarantees information in Report. Nevertheless, information in the table "Production in volume terms" on page 27 of the Report doesn't reflect SOCAR's share in PSAs (from oil and gas reserves point of view). Diagrams in Report next to this table have the same shortcoming which prevents from having a picture of SOCAR's power and capabilities. This approach doesn't properly reflect the capitalization of SOCAR. Assessment of the report that was conducted by us showed that majority of the information required by this semi-paragraph of Standard is not included to the Report. For example, there is no data in the Report on obligations of SOCAR towards Ministry of Finance, State Oil Fund, Social Protection Fund, Central Bank, and International Bank of Azerbaijan Republic and the allocations from the government to SOCAR. In the meantime, there isn't any information available in the Report regarding financial investment operations conducted by SOCAR through its foreign subsidiaries and particularly the flow of funds between company and foreign enterprises, reinvestment and funding of third parties. In our opinion and based on the requirement of this particular semi-paragraph of the Standard, 2013 EITI Report should have contained explanations on Charter of the State Oil Company of the Azerbaijan Republic, Law of the Republic of Azerbaijan "On State Budget of the Republic of Azerbaijan for 2013", Tax Code of the Republic of Azerbaijan, Decision No. 102 of the Cabinet of Ministers dated June 9, 2005 "On Income and Expenditure Estimate of Large taxpayers"⁴, paragraph 1.1.4 of the IMF's "Fiscal Transparency Guide" of, on "Relations between Government and Public Corporations" and some other documents.

2.6.3. If participation of the government in the extractive industry brings about significant increase of revenues according to semi-paragraph 3.6.b) of the Standard, EITI Report should contain information on quasi-fiscal expenditures of state companies, including social services, public infrastructure, fuel subsidies and repayment of the state debt. We should have mention that using large national extractive companies in implementation of social and infrastructural functions of government and separate government institutions is widely practiced in many countries. In majority of cases this practice is an essential and effective measure due to the existing conditions (for example, limited financial resources of government; fostering local producers by selling energy inputs to them at relatively low prices; national mining company having more reliable financial control mechanisms etc.). Quasi-fiscal operations of the national extractive companies shouldn't be recognized as totally negative process or a corruptive element. Pertaining to this requirement EITI Report says following: "SOCAR didn't participate in the repayment of state debt, provision of social services, creation of public infrastructure and any quasi-fiscal expenditures such as fuel subsidies, whatsoever" (page 30). However, findings of the investigations by EITI NGO Coalition experts were completely opposite to it. Below is list of SOCAR's quasi-fiscal activities matching 3 out of 4 quasi-fiscal activity types identified by IMF:

2.6.3.1. *Quasi-fiscal activities in the energy inputs field* – SOCAR is constrainedly providing fuel and energy inputs at lower than actual market prices to the local consumers. As a

⁴<http://e-qanun.gov.az/framework/10044>

matter of fact, the prices of fuel, oil products and gas provided by SOCAR to domestic consumers and set by the decisions of the Tariff Council of the Republic of Azerbaijan dated January 6, 2007 were lower than the global market prices of oil, oil products and gas for 2013. Collection of the price margin between contract (sale) price (less export costs) and domestic wholesale price for the domestically produced products which prices are regulated by the “Law on State Budget” since 2007 is reasoned by above mentioned fact and confirms our conclusion. We would like to notice that in 2013 state budget received 370.56 million AZN from this specific payment source.⁵

2.6.3.2. *Quasi-fiscal activities in the field of public expenditures*—Examination of SOCAR’s annual reports for 2013 figured out that within a reporting year Company provided numerous social services which were originally assigned as functions of individual state agencies and undertook cost-intensive projects on creation of infrastructure.⁶ Although, SOCAR’s Charter provides for the participation of Company in the activities implemented by government under the socio-economic development programs, there are no regulations of Cabinet of Ministers for SOCAR’s or any other government agencies’ participation of . There are some programs related to the improvement of living conditions of IDPs where the instructions for SOCAR are displayed in more descriptive way, however it is not the case with other state programs where SOCAR’s participation is outlined just in general terms. SOCAR’s 2013 reports and web pages, as well as reports and web pages of the relevant state agencies do not contain any information regarding implemented works and key contracts signed in this regard. By the way, the Ordinance of the Cabinet of Ministers of the Republic of Azerbaijan No.443 dated December 30th, 2011 provides for “the accomplishment of measures to ensure a fulfillment of liabilities arising from relevant national programs and international projects where SOCAR is an executive agency at the domestic expense⁷”.

2.6.3.3. *Quasi-fiscal activities in the field of employment* - Several steps have been taken over the recent years towards the improvement of SOCAR’s structure and optimization of its employment size, decreasing the number of employees, setting Company free from excessive employment and excessive social expenditures. However, findings from the investigations of SOCAR’s activities in the sphere of sports give reason to suggest, that the funding mechanisms of such activities are not transparent and there are employment related quasi-fiscal operations of Company. Although, information⁸ regarding the activities and achievements of Company sports and particularly “Neftchi” Sports and Health Center is disclosed in annual reports of SOCAR, still there is no information to verify whether professional athletes and coaches are SOCAR staff members and who is defraying the sport facilities’ and athletes’ expenses. Although, there isn’t any information in Company accounts, its official web page or web page of “Neftchi” Football Club regarding its belonging to SOCAR. . There’s also need for clarity in financial relations of SOCAR with Azerbaijan Association of Football Federations (AFFA) and CBC television

⁵Law of the Republic of Azerbaijan No 958-IVQ dated May 16, 2014 on implementation of 2013 state budget of the Republic of Azerbaijan

⁶SOCAR: Sustainability Report – 2013, Page 48-50 <http://socar.az/socar/az/social-responsibility/social-support/care-about-displaced-persons>; SOCAR: Annual Report 2013, pages 103-104 <http://socar.az/socar/assets/documents/az/socar-annual-reports/illik-hesabat2013az.pdf>

⁷<http://e-qanun.gov.az/framework/22855>

⁸SOCAR: Annual Report – 2013. Page 108; SOCAR: Sustainability report – 2013, page 51

channel. Having all above in mind, we believe it is essential to increase focus on quasi-fiscal operations of SOCAR in EITI Reports.

2.6.4. Semi-paragraph 3.6.c requirement 3 of the Standard requires inclusion of beneficiary ownership information of state companies in EITI report. Information on SOCAR's beneficiary ownership disclosed in 2013 EITI Report identifies a share of state-owned company in its joint ventures and associated companies, size of revenues, assets and liabilities. All this information pertains to SOCAR only. However, EITI Standard requires state-owned companies to include information on their share in joint ventures and associated companies and responsibility to defray the costs at various stages of the project for example: capital paid in full, disposable capital and semi-active (nominal) equity interest (Report describes information on government's takes). Meanwhile, government and state authorities are required to disclose detailed information on terms of transactions including assessment and revenues in case if any changes occur in ownership level of government and state organizations within the EITI reporting period. If government- and state-owned enterprises provide loans and loan guarantees to domestically operating mining, oil and gas companies, the details of such transactions should be disclosed in EITI Report. 2013 EITI Report states that there were no changes in the beneficiary ownership level between government and SOCAR within this reporting period. Meanwhile, there wasn't any change in the beneficiary ownership of SOCAR-affiliated enterprises and joint ventures within a reporting period (pages 29-30). However, when reconciled with SOCAR's Consolidated Financial Report⁹ it appears that the government didn't disclose sufficient information and about changes on beneficiary ownership of State Company in EITI report. It also becomes apparent from SOCAR's Consolidated Financial Report that increments were made to Foundation Capital of joint ventures and associated companies of SOCAR along with investments and other modifications in the same year. Let's review below extracts from the Consolidated Financial Report of Company regarding the modifications in the capital of joint ventures and associated companies, investments and other changes¹⁰:

- *In 2013 Socar Turkey Yatirim A.S. which was established by SOCAR bought all shares of STEAS for STAR processing plant. Subsequently, Socar Turkey Yatirim A.S. sold 40% of shares to the Ministry of Economy and Economic Development and 18.5% to Turcas. Group's share in Socar Turkey Yatirim A.S. is 41.5% and is recorded by capital method of accounting.*
- *During 2013 Group invested 144 million AZN into chartered capital of Socar Turkey Yatirim A.S. In July 2013, SOCAR Group bought remaining 50% of shares of SOCAR International DMCC. As a consequence Group took a control of SOCAR International DMCC.*
- *During 2013, SOCAR invested additional 84 million AZN and 19 million AZN into foundation capital of SOCAR Umid MMC and Azerbaijan Rigs MMC enterprises which SOCAR's joint ventures.*
- *In July 2013, shareholders' agreement with Star Gulf FZCO was modified and SOCAR took control over this joint venture (without any payment by SOCAR). Consequently Star Gulf*

⁹SOCAR: Financial Report 2013, <http://socar.az/socar/assets/documents/az/socar-financial-reports/Maliyye.hesabat.2013.pdf>

¹⁰SOCAR: Financial report 2013, pages 46 - 52

FZCO and “BosSelf”MMC (Star Gulf FZCO has 50% interest in this company) were transformed into subsidiary enterprises of SOCAR.

- In the second half of 2013 subsidiary company of SOCAR – SOCAR Overseas obtained remaining 49% of the interest from SOCAR Petroleum and as a result took full control over this company. In July 2013, SOCAR obtained remaining 50% of the shares of the associated company SOCAR International DMCC. As a result of 30 million AZN investment by SOCAR International DMCC into SOCAR Aurora Terminal made the latter one of SOCAR joint ventures.

Above mentioned necessitates improvement of related section in EITI Report.

2.7. Paragraph 3.7 of the requirement 3 of Standard requires description of revenue distribution and its use to be published in EITI reports. Based on this requirement EITI report should reflect specifically those extractive revenues (in monetary and volume mean) which are noted in state budget. Revenue distribution should be explained if revenues are not reflected in state budget. Section 3.6 of 2013 EITI Report contains information on revenue collection sources and expenditures distribution of State Oil Fund in 2013. However, there is no information on incomes to state budget from extractive sector. Detailed information regarding state budget revenues from extractive industries is available in the Budget Pack which is submitted by government to Milli Mejlis (National Parliament).together with draft budget law Systematization of those data and including them into appropriate section of the Report would help meet to Standard’s requirements and contribute to improvement of the Report itself.

2.8. Paragraph 3.8 of the Standard encourages the inclusion of the additional information on revenue management and expenditures. Although, MSG agreed not to include the encouraged Standard requirements to 2013 report, NGO Coalition Council considers inclusion of such information in next years’ report a contribution towards enhancing country’s transparency image.

2.9. EITI Report includes information on paragraphs 3.9 and 3.10 of the Standard. However, we believe it is essential to improve such information and make it in more precise in next years’ reports. It is known that license allocation for some business activities in the Republic of Azerbaijan is regulated by the Decrees of the President of the Republic of Azerbaijan.¹¹ However there is no special licensing and permission (licenses) allocation for exploration and production activities in extractive industry. Information on issue of permissions in this sector (PSA termination procedures) is briefly explained in “Roles and responsibilities of the relevant state agencies” section of the Report. Charter of the Ministry of Energy is shown as a key regulatory tool in this regard¹². The procedure itself is described very generic and briefly in Charter. Generally speaking, regulatory tools for operations in the extractive industries in Azerbaijan should be reflected in the legislation in more precise and comprehensive terms both for local and foreign investors.

2.10. Disclosure of the beneficiary ownership information based on the paragraph 3.11 of the Standard will be required only from 2016 onwards. As it was mentioned in our EITI Report

¹¹<http://e-qanun.az/framework/898>

¹²http://www.minenergy.gov.az/db/EN_Esasname.pdf

Review and based on the Law on amendments to the Law of the Republic of Azerbaijan on “State registration of the legal entities and state register” dated June 12, 2012 information regarding founders of the legal entities in Azerbaijan is treated as commercial secret. That information can be obtained by third parties only with consent of the shareholders of the enterprise. Thus, NGO Coalition Council finds discussions on this topic in MSG appropriate and recommends applying to relevant state agencies in order to resolve this issue prior to beginning of EITI Report development for 2016.

2.11. Last 3.12 paragraph of the requirement 3 of the Standard is related to information on contracts. It says that, EITI implementing countries are encouraged to publicly disclose any contracts and licenses on production of the oil, gas and minerals. We have to note that, pages 19-20 of the 2013 EITI Report contains a list of oil and gas contracts, dates of contracts, contract parties and their shares. Although, there was a decision of MSG on publishing oil and gas contracts of Azerbaijan on EITI web page, due to some reasons the implementation of this decision is set aside. It is essential, in our view, to increase an attention of local EITI Secretariat on solution to this issue.

III. Analysis of the main section of the report (reconciliation process and its results).

Requirement 4 of the Standard requires full reflection of all government revenues and all significant payments by extractive companies to the government in EITI report. Section 4.1 of the Standard describes the requirements on payments and revenue types to be covered by EITI Report.

EITI Report states that, based on the discussions at the 34th MSG meeting held on December 10, 2014, information on infrastructure provisions and barter operations, sub-national payments and transfers and social expenditures are not included into 2013 EITI Report since they are not applied in the Republic of Azerbaijan. In other word, apart from that all other payments and proceeds pertaining to the extractive industry was reflected in EITI Report.

By examining and analyzing this section of the report we identified the following:

3.1. An explanation of discrepancy of 22.2 million USD in the amount of payments made by foreign oil companies from their revenues to the government can't be considered as exhaustive.

In the “5.6 Amendments” section of the report there is an explanatory table of this discrepancy (page 41). It appears that, although Bahar Energy Limited and Binagadi Oil Company transferred accordingly 0.1 and 5.1 million USD to SOCAR, these transfers were recorded as transfers to government in reporting templates. Such mistake is understandable. However there is no explanation of the reason for wrong recording of the amounts of 14.4 million USD and 2.6 million USD of Ali Bayramli MMC and Salyan Neft MMC in reporting templates. How could these amounts be recorded in report templates, if they were not paid to any institution? We assume that, the amounts were somehow transferred and mistakenly included into reporting template. We believe it is necessary to bring clarity over this issue.

3.2 There is some ambiguity in transportation and transit revenues information. EITI Standard (paragraph 4.1 f) says that “if revenues from the transportation of oil, gas and mineral resources constitute one of the major revenue streams in the minerals production sector, the information regarding such revenues is required to be disclosed by government and state-owned enterprises”. Currently transportation revenues seem little compared to the large revenues of production sector. Nevertheless, considering large transportation infrastructure of the country (strategically important oil and gas pipelines, sea and railway transportation) and strategic transit potential, MSG should gradually achieve inclusion of transit revenue information included into EITI report.

Transportation and (or) transit revenues information is provided in very vague and superficial way both in contextual and reconciliation part of the 2013 report. Transportation and transit revenues information is presented in diverse places of the report by different names, which causes complexity:

- 1) Section 3.6 (page 31) in the table of sources of revenues of SOFAZ, “payment of transit fees” is indicated as 8.1 million AZN;
- 2) Section 5.1 in reconciliation table on foreign extractive companies (page 36), “transportation tariff to SOFAZ” indicates amount of 10.3 million USD. The exchange rate for the relevant period shows these indicators appear to be identical.

This amount is stated as “revenues from the transport of oil and gas through the territory of the Republic of Azerbaijan” in the decree of the President of the Republic of Azerbaijan dated May 22, 2014 on budget implementation of SOFAZ for 2013 (the amount is 8.1 million AZN).¹³ It is also presented as “transit fees payments” in 2013 Annual Report of SOFAZ (page 36) (amount is 10.3 million USD)¹⁴. It is necessary to have more clear explanation of a discrepancy of 6.6 million USD identified in reconciliation process on this type of payment pertaining to what extracting companies and government provided in reconciliation table (page 36) in the Report (“5.6. Amendments section”, page 42). The explanation says that this amount is the amount paid by SOFAZ for the transportation of the profit oil on behalf of the government of Azerbaijan through Western Route Export Pipeline. Hence from explanation it appears that this amount was paid by SOFAZ to AIOC. Explanation stresses that “due to the specificity of transaction this difference is permanent”. Therefore, we find it necessary to have more precise explanation of the flow mechanism of this amount.

Information on the dividends obtained by government from the main export pipeline BTC was available neither in 2013 EITI report nor in SOFAZ reports despite the fact that this information was in those reports until 2012.

3.3. 17 million AZN difference in the amount of the profit tax paid by SOCAR to the government requires additional comments. As of section 5.6 of the report the reason for 17 million azn difference in “profit tax payments made by local companies to government” was explained by mutual protocol of government budget tax liabilities of SOCAR.

¹³http://www.oilfund.az/az_AZ/huequqi-senedler/fondun-buedcesine-dair/fondun-budcesine-dair-22052014.asp

¹⁴http://www.oilfund.az/uploads/annual_2013az.pdf

We deem Independent Administrator should have mentioned a legal basis for it, since only then reciprocal settlement of taxes payable can be accepted as in compliance with regulations.

3.4. There is un-clarity in information on natural gas delivered to government in volume mean. In accordance with the initial report templates on page 9 of the EITI Report there is a table that reflects net difference between the payments indicated by companies and government and the amount of revenues following the completion of the reconciliation process and elimination of discrepancies. As it appears from table, in reporting year Government received 13351.8 thousand m³ of natural gas from extracting companies. However companies didn't include this information in report template and only following a reconciliation relevant corrections were made. Page 36 of the report in sub-section 5.1 contains table 2, which represents information on summary of transfers of foreign extracting companies to the government in volume mean. Based on the information presented in that table, Government received **13351.8 thousand m³** of natural gas from foreign extracting companies. The companies again didn't include information to initial report templates and only following reconciliation they confirmed the information and eliminated the difference. It appears from the information on page 44 of the report that it was Bahar Energy Ltd that made this mistake. The company did not include mentioned information to report, although made allocation to SOCAR. Audit report said: "Company did not include information on the amount of the natural gas transferred to SOCAR. We have reviewed these transfer operations and corrected the discrepancies".

Summary table on Bahar Energy allocations on page 64 of the report also reflects amount of gas transfer by company to the government. In the meantime, table 2 of the sub-section 5.4 on page 39 of the report includes information on transfers from extracting companies to the government in volume means. It appears from the table that **13351.8 thousand m³ of natural gas** were delivered by extracting companies to the government and government acknowledged a receipt of the delivered gas. It appears from the summary table on SOCAR on page 87 of the report that SOCAR is a company which delivered the same amount of natural gas to government. So it ultimately appears that on page 9 of the report a volume of the gas delivered to and received by the government is **13351.8 thousand m³**, however based on information in the section 5 of the report both foreign and local extracting companies delivered same amount of natural gas to the government In 5.6 "Amendments" section of the report. it is mentioned that Bahar Energy Ltd transferred natural gas to SOCAR It appears that, the same gas volume was delivered by Bahar Energy Ltd to SOCAR and SOCAR in its turn transferred that gas to the government. There is non clarify here: It not clear why SOCAR is delivering natural gas to government while being a gas user on behalf of the government? We think that this issue should be clarified. Although report indicates that extracting company delivered natural gas to the government (actually to SOCAR as government's representative) it also indicates that same gas was delivered to government by SOCAR. Subsequently a same indicator appears in two different parts of Report which creates unnecessary ambiguity.

3.5. Above mentioned gap was observed in the case with associated gas too. Sub-sections 5.1 and 5.4 of the report contain information on delivery of the same volumes of associated gas by both foreign and local extracting companies to SOCAR. However, it appears from investigation that mentioned amount of associated gas was delivered by foreign extracting companies to SOCAR.

3.6. There is unclarify regarding the volumes of the in kind natural gas delivered by UGE-Lancer PTE LTD to the government. From the table of payments of UGE-Lancer PTE Ltd on page 96 (“Amendments” section of the report) it appears that this company delivered **5328.8 thousand m³ of natural gas** to the government in reporting year and the government acknowledged it. However, this fact was not reflected in the section of in kind payments made by foreign extracting companies to the government , i.e. neither in the generic table 9 nor in the table 2 of the sub-section 5.1 on the page 36 of the report. As we have stated above the report (table 2 of the sub-section 5.1) states delivery of **13351.8 thousand m³ of natural gas** by foreign extracting companies to the government and the company which defrayed this amount was Bahar Energy Ltd. So why information on amount of natural gas that was delivered by UGE-Lance PTE Ltd (which was acknowledged by government) was not included into summary table?

3.7. Information on the volumes of the associated gas delivered by foreign extracting companies to the Government is indefinite. Table 2 of the sub-section 5.1 on the page 36 of the report indicates on **2310248 thousand m³ of associated gas** delivered by foreign extracting companies to the Government. If to make calculations based on the relevant data in the tables from the attachments section of the report it appears that companies delivered **2304919,1 thousand m³** of associated gas to the government which creates **5328,9 thousand m³** difference. Independent Administrator is required to bring clarity over this issue.

IV. Conclusions and Recommendations

The Council of ITEI NGO Coalition came to the following conclusions by thoroughly investigating EITI Report of the Republic of Azerbaijan for 2013, assessing its compliance with EITI Standards and after necessary analyses:

- There is a large amount of information accumulated in 2013 EITI Report pertaining to the role of the extractive industry in public revenues and country economy that is significant for the citizens of the country and all stakeholders; this information was not public so far. Thus, we should consider this Report as a step forward towards increasing a transparency in the activities of government and extracting companies;
- 2013 EITI Report of the Republic of Azerbaijan has been developed in compliance with majority of the requirements of EITI Standard;
- However, there are cases of partial and full non-compliance with the requirements of EITI Standard including deficiencies in reconciliation process and unclarities mentioned above.

The Council of ITEI NGO Coalition makes below proposals and recommendations to eliminate non-compliances and un-clarities versus EITI Standard and deficiencies from reconciliation process of the 2013 EITI Report of the Republic of Azerbaijan and for further improvement of EITI Reports for the next years:

1. Multi-Stakeholder Group is recommended to:

- 1.1** Ensure that summary of relevant ordinances and decisions of the Cabinet of Ministers on extracting industry and fiscal regime are included into the Report along with laws and decrees.

- 1.2 Ensure that modifications (reforms) of legal norms, fiscal regime and role of state agencies within a reporting year is included into report together with comments;
- 1.3 Include investment and employment indicators of individual extracting companies in the EITI Report together with contribution of the extracting industry to the economy in reporting year since this is reasonable.
- 1.4 Include the information regarding the size of reserves of all field and product types(oil, gas, condensate, gold, silver etc.) to contribute to further enhancement of transparency;
- 1.5 Ensure that information based on the requirement 3.5 of the EITI Standard (value of the products based on the total production volumes and types, value of the exported products based on the total export volumes and types) is included in EITI country reports for next years;
- 1.6 Undertake necessary measures to include integrated data on debt liabilities of the State-owned company and particularly data on financial relations balance of SOCAR with related agencies;
- 1.7 Keep in attention the inclusion of information regarding transfers and distribution of assets, reinvestment and funding of third parties between SOCAR and government and government agencies and SOCAR and large private companies and banks;
- 1.8 Increase focus on quasi-fiscal operations of SOCAR in EITI Report and request the Independent Administrator to provide more comprehensive data on sub-section 3.6 b of the Standard for next year report;
- 1.9 Start discussions with participation of experts on beneficiary ownership of state-owned enterprises, SOCAR's quasi-fiscal activities and social expenditures and bring clarity over the requirements arising from EITI Standard in those particular directions;
- 1.10 Undertake necessary measures to include information on general assets managed by SOCAR's subsidiaries, associated companies and joint ventures operating overseas, changes in capital and liabilities to defray costs of the project at its various stages;
- 1.11 Discuss opportunities of taking steps towards inclusion of information which is encouraged by EITI Standard to be disclosed into next years' EITI report to enhance transparency image of our country;
- 1.12 Undertake discussions in MSG to resolve beneficiary ownership issue and make requests to relevant state agencies on necessary steps before the 2016 EITI Report preparations are given a start;
- 1.13 Bring the matter of necessity to expedite the implementation of previous MSG decisions on publishing oil and gas contracts of Azerbaijan on EITI website to the attention of local EITI Secretariat. Complete the actions to ensure product sharing agreements are publicly available within a short time;
- 1.14 MSG should bring clarity over the terms of "transportation" and "transit" considering significance of transportation revenues for Azerbaijan and come up with initiative before EITI Board in this regard;
- 1.15 Include activities targeted at inclusion of transportation revenues to EITI report and its application to country Action and make a request to EITI Board to receive technical assistance in this field;

2. Independent Administrator is recommended to:

- 2.1 Add information about contribution of extractive industry to local (municipal) budgets (fiscal devolution) to report;
- 2.2 Make correction to the information regarding subordination between SOCAR and the Ministry of Energy on the page 16 and undertake necessary editing and stylistics works in the section 3.5a of the report;
- 2.3 Provide explanations of rules and practices regulating financial relations between SOCAR and government related to SOCAR's participation in extractive industry and expand information on mutual transfers. Include information on payments made by SOCAR to state agencies and the amounts received by Company from government;
- 2.4 Accomplish further expansion of SOCAR related information section by using SOCAR's consolidated financial statements and other annual reports and ensure that information in the report reflects real strength and capacity of the Company in more comprehensive way;
- 2.5 Take actions to include information regarding quasi-fiscal operations of SOCAR by requesting relevant data from company and carrying out necessary calculations;
- 2.6 Expand information in line with Standard regarding the ownership of SOCAR in joint ventures, associated companies and subsidiaries and changes in level of ownership and include information regarding all joint ventures and associated companies of SOCAR to the report;
- 2.7 Obtain detailed information in line with requirement 3.7 of the Standard regarding the budget revenues that come from extractive industry (from the budget pack presented together with an annual budget law to Parliament) from the Ministry of Finance and include that information into EITI Report;
- 2.8 Clarify the terms of "transportation tariffs" and "transit revenues" in both contextual information and reconciliation sections;
- 2.9 Ensure an explanation of the discrepancy to the amount of 6.6 million USD in transit revenues between information of foreign extracting companies and the government. Ensure clear explanation of flow mechanism of funds paid by government to State Oil Company for transit of government part of profit oil through Western Route Export Pipeline.
- 2.10 Bring clarity over non clarities regarding the reconciliation outcomes presented in this review. ((volumes of the natural gas and associated gas delivered to the government, mutual payments on SOCAR's profit oil, payments made by foreign companies to the government from their oil revenues etc.) and ensure that necessary measures are taken to prevent such deficiencies in next years' reports;
- 2.11 Based on EITI Standard requirements ensure that companies and state agencies engaged in reporting process have passed audit process in accordance with international audit standards.

3. SOCAR is recommended to:

- 3.1 Conduct a presentation of SOCAR's annual financial report to the experts-members of the EITI NGO Coalition and provide responses to questions regarding company's financial reports;

- 3.2 Conduct special investigation on the impacts from mandatory sale of oil, gas and oil products to domestic consumers at lower than market prices to Company and its financial situation; evaluate quantitative and qualitative affects;
- 3.3 Conclude necessary contracts with relevant state agencies on all types of social activities (projects) separate state programs that do not have direct relation to SOCAR's agenda and
- 3.4 Ensure that company's annual reports reflect its annual expenditures on all types of social activities of including sports;
- 3.5 Expand cooperation of MSG and Independent Administrator to ensure more comprehensive and improved information regarding Company in next EITI Reports.

4. The Government is recommended to:

- 4.1 Take set of measures to reduce quasi-fiscal activities of SOCAR;
- 4.2 Specify precisely the cases when SOCAR can participate in state programs in case if it they are not in line with company's functions and regulations;
- 4.3 Take necessary actions to eliminate cases of engagement of SOCAR in implementation of social activities that are under direct responsibility of other state agencies;
- 4.4 Make a request to the EITI Board with an initiative to include transportation revenues in next EITI report in a pilot way taking into account increase in transportation and transit revenue amounts.
- 4.5 Considering the complexity and technical difficulty of EITI reporting on transportation it would be reasonable to organize relative information provision in two stages: to ensure full inclusion of information on revenues generated from the pipeline transportation in next report; and to include information on both railway and sea transportations from 2016 onwards;
- 4.6 Government should apply to relevant agencies and transportation companies (particularly sea and railway transportations) and ask them to provide support in provision of required information;
- 4.7 Take necessary measures to ensure that state agencies engaged in reporting process are audited under the international audit standards as required by EITI Standard.

Council of ITEI NGO Coalition encourages MSG to be active and take extensive measures to bring 2013 EITI Report of the Republic of Azerbaijan to the knowledge of wider public. Council of NGO Coalition hopes that Government Commission and companies will take proposals which are designed to improve Azerbaijan's EITI experience further seriously.

This can definitely play significant role in increasing trust and confidence of civil society towards EITI process and accountability system.